DOCUMENT RESUME

ED 432 169 HE 032 141

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TITLE State Sponsored College Savings and Prepaid Tuition Programs.
INSTITUTION Kansas State Legislative Research Dept., Topeka.
PUB DATE 1997-10-21
NOTE 7p.
PUB TYPE Reports - Descriptive (141)
EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Higher Education; In State Students; Investment; Parent Financial Contribution; *Paying for College; State Legislation; *State Programs; Student Financial Aid; Tax Credits; *Tuition
IDENTIFIERS *Prepayment Plans; *United States (Midwest)

ABSTRACT

This report provides an overview of state-sponsored college savings and prepaid tuition programs. It notes that as of October 1997, 41 states had one or more state-sponsored college savings or prepaid tuition programs. The report explains that state-sponsored savings plans provide certain incentives for savers through a number of different financing or taxing mechanisms, while prepaid tuition plans allow individuals to prepay or pay into special funds or trusts over a period of years with the guarantee of payment of tuition at an institution of higher education at a later point in time. The report goes on to provide brief descriptions of college savings and prepaid tuition programs--or legislative activity to establish such programs--in Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Nebraska, North Dakota, Ohio, South Dakota, Wisconsin, and other states. An appendix provides a listing of current college savings and prepaid tuition programs. (MDM)

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October 21, 1997

ED 432 169

To: Legislative Educational Planning Committee

From: Julian Efird, Principal Analyst

Re: State Sponsored College Savings and Prepaid Tuition Programs

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October 21, 1997

To: Legislative Educational Planning Committee

From: Julian Efird, Principal Analyst

Re: State Sponsored College Savings and Prepaid Tuition Programs

According to information compiled by the National Association of State Treasurers and reported by the College Savings Plan Network, as of October 2, 1997, there are 41 states which have one or more state sponsored college savings or prepaid tuition programs. Some 19 of the states have what are labeled as new, or recently created, programs. Prepaid tuition or tuition trust programs are found in 22 states. Savings bond, savings plan or savings plan trust programs are found in 21 states. Ohio and Illinois offer both plans—a prepaid tuition program and a savings bond program. The summary information for state programs is found in Attachment 1.

At the start of calendar year 1997, an earlier report from the National Association of State Treasurers showed that 18 states had established either savings or prepaid tuition programs. The increase in the number of states with programs occurred after Congress passed 1996 legislation resolving questions over federal tax treatment of qualified state programs. Those 23 states with new programs do not necessarily have active, functioning programs.

Types of State Programs

There are two types of programs that have been adopted in a number of states since 1986: state sponsored college savings plans and guaranteed tuition plans. For families with children or for individuals who might attend college in the future, such state sponsored plans offer an opportunity to finance college costs by methods other than loans which must be repaid, along with the interest accrued.

Guaranteed tuition plans, which are usually referred to as prepaid tuition programs, are designed to allow persons to pay into special funds or trusts over a period of years amounts to prepay or guarantee the payment of tuition at an institution of higher education at a later point in time. State sponsored savings plans, by contrast, provide certain incentives for savers through a number of different financing or taxing mechanisms.

Some states that have enacted a prepaid tuition program have followed the Michigan model, often referred to as "contract-based" plans which require either by lump sum or by fixed monthly installments the prepayment of two or four years of tuition. Other prepaid tuition plans, referred to as "unit-based" programs, generally allow purchasers to prepay increments of future tuition, such as credit hours, over time. Prepayment does not guarantee future admission of a particular student to an institution since the qualifications must be met. The money paid by participants is pooled by the state and invested with the goal of obtaining a rate of return that beats the inflation rate for tuition and other college fees. Most state plans offer an exemption

from state income taxes on the appreciated value of the investment used to pay tuition, and some states allow contributions to be exempt from state income taxes as well.

State sponsored savings plans, by contrast, provide certain incentives for savers through any number of different financing mechanisms. The plans do not guarantee to keep up with tuition inflation. Three investment mechanisms have been identified with state savings plans. College savings plans involve a variety of methods of financing, some of which require considerable government funding, while others have relatively low state costs. Government costs usually are related either to the use of public subsidies to raise the prospective rate of return on the savings or to the use of tax exemptions for savers. College savings plans have resulted from state legislation specifically authorizing new programs, or, in some cases, from bonds that were sold through state executive offices under existing bond authority.

The two types of state sponsored programs are less distinct in practice. In fact, some states, such as Massachusetts, have combined the different plans into hybrid programs, and other states, such as Ohio, have offered both programs separately. The new federal legislation provides a federal income tax exemption on the appreciated value for both types of programs. If certain qualifications are met, the state entity offering the program will be treated as a tax exempt agency and participants will benefit from tax deferred treatment, with federal taxation occurring at the time of distribution. If the funds are used for tuition or other qualified purposes, then the federal tax will be only on the appreciation in value over the original purchase price or investment, and will be payable by the student, based on the student's presumably lower rate of taxation. Recent 1997 federal legislation expanded the qualified uses to include room and board charges.

Midwest Regional Survey

The Midwestern Office of the Council of State Governments (CSG) surveyed this region's states and the results appeared in a September 1997 issue of *Firstline*. Eleven states, including Kansas, that comprise the Midwest region for the Council of State Governments are included in the survey.

Illinois. In legislation passed this year, the Illinois Prepaid Tuition Fund is established. The program is intended to create a tax-exempt program that allows families to prepay college costs over a period of five or ten years.

Indiana. The Indiana Education Savings Authority administers legislation passed in 1996 that authorizes two programs: the Family College Savings Program and the Save Indiana Program. The first program will operate as a conventional savings plan with tax incentives that promote saving for college. The second program will award a flat grant toward college tuition at the state's postsecondary institutions in order to reward those who save a predetermined amount.

Iowa. According to CSG, no bills passed during the 1997 legislative session to create any programs, although several prepaid tuition and savings bills were considered. This information contradicts the National Association of State Treasurers information that a new savings plan trust program was enacted this year and will be implemented in 1998.

Kansas. There were no prepaid tuition or savings bills introduced during the 1997 Legislature.

Michigan. Enabling legislation passed in 1986 and the Michigan Education Trust is the oldest state prepaid tuition program, operating since 1988. The persistence of the Internal Revenue Service questions about the Michigan program and other similar plans contributed to the 1996 Congressional action clarifying the tax exempt status of state prepaid tuition and savings programs.

Minnesota. New legislation was passed in 1997 to encourage residents to save for college by investing in affordable, tax free savings bonds that can be used for college expenses. Provisions call for the state to sell general obligation bonds, known as "Gopher State Bonds," in denominations as small as $500.

Nebraska. There were no prepaid tuition or savings bills introduced during the 1997 Legislature. However, a bill establishing the Resident Tuition Assistance Grant was introduced to help Nebraska residents attend a private rather than a public institution. The bill did not pass.

North Dakota. The Legislature failed to adopt legislation that would have established a college tuition savings account program. The bill called for a program to operate as a prepaid tuition plan that would allow residents to purchase tuition credits.

Ohio. The state has operated a prepaid tuition program since the late 1980s when the Ohio Tuition Trust Authority was created by legislation. The program allows residents to purchase tuition units which are based on the average price of an Ohio public four-year institution. Students who attend college my apply the units to cover the cost of tuition at any college in the nation. The state also offers college savings bonds which are exempt from state and municipal taxes.

South Dakota. A bill to authorize a task force to review prepaid postsecondary education tuition plans was introduced, but killed in committee during 1997.

Wisconsin. In 1996, legislation was enacted to create the EDVEST WISCONSIN program that allows purchases of tuition units. Students may use these tuition units toward undergraduate tuition and fees at any institution nationwide. Earnings from these investments are exempt from state income tax. The price of tuition units is based on estimates of future tuition at the University of Wisconsin.

Other States. Missouri and Oklahoma were not covered by the CSG survey, but information from the National Association of State Treasurers would indicate that both states considered legislation in 1997 authorizing new prepaid tuition programs. However, it does not appear that either state enacted a bill in 1997.

Colorado, on the other hand, passed legislation in 1996 to create a prepaid tuition program. The program allows students to use prepaid tuition throughout the United States at public and private colleges, universities, and vocational schools; to pay for tuition, fees, room and board, books and supplies; to pay federal income taxes on the increased value that is deferred until funds are used for education; and for the increased value to be exempt from Colorado income tax. Participants may choose either monthly installments or a single lump sum payment, and investments can be transferred to another family member. The Fund is managed by the Colorado Student Obligation Bond Authority using private sector investment professionals.

ATTACHMENT 1

State College Savings Programs Overview

State	Program Name	Program Type and Status
Alabama	Prepaid Affordable College Tuition (PACT)	Prepaid Tuition
Alaska	University of Alaska Advance College Tuition Payment Plan	Prepaid Tuition
Arizona		Savings Plan Trust
Arkansas	Arkansas College Savings Bond Program	Savings Bonds
California	NA	Savings Bonds (prepaid program pending)
Colorado	Colorado Prepaid Tuition Fund	Prepaid Tuition
Connecticut		Savings Plan Trust pending
Delaware	Family Account for College Tomorrow (FACT)	Plan Trust
Florida	Florida Prepaid College Program	Prepaid Tuition
Georgia	Georgia HOPE Scholarship Program	100% tuition scholarships from lottery funds
Hawaii		Studying feasibility
Idaho		Studying feasibility
Illinois	Illinois College Savings Bond Program	Savings Bonds; pending Prepaid Tuition
Indiana	Indiana Education Savings Authority	Trust fund w/savings education program
Iowa		Savings Plan Trust pending
Kansas		**Studying feasibility**
Kentucky	Kentucky Educational Savings Plan Trust	Savings Plan Trust
Louisiana	Louisiana Tuition Trust	Tuition Trust
Maine		Prepaid tuition pending
Maryland		Prepaid Tuition
Massachusetts	U-Plan—The Massachusetts College Savings Program	Prepaid Tuition
Michigan	Michigan Education Trust	Prepaid Tuition
Minnesota		Savings Plan Trust
Mississippi	Mississippi Prepaid Affordable College Tuition Program (MPACT)	Prepaid Tuition
Missouri		Savings bonds; also, legislation passed for prepaid
Montana		Savings Plan Trust
Nebraska		Studying feasibility
Nevada	Zero Coupon Bonds for Nevadans	Savings Bonds; Prepaid Tuition pending
New Hampshire	NH College Savers	Savings Bonds; Savings Plan Trust
New Jersey		Prepaid Tuition passed
New Mexico		Savings Plan Trust
New York		Program legislation passed
North Carolina		Savings Plan Trust
North Dakota		Studying feasibility
Ohio	Ohio Tuition Trust Authority	Prepaid Tuition and Savings Bonds
Oklahoma		Legislation authorizes prepaid tuition.

Oregon		Savings bonds and legislation pending for prepaid
Pennsylvania	Pennsylvania Tuition Account Program	Prepaid Tuition
Rhode Island		Savings Plan Trust pending
South Carolina		Prepaid Tuition pending
South Dakota		Legislation pending
Tennessee	Tennessee BEST	Prepaid Tuition
Texas	Texas Prepaid Higher Education Tuition Program (TOMORROW)	Prepaid Tuition
Utah	Utah Educational Savings Plan Trust	Savings Plan Trust
Vermont		Studying feasibility
Virginia	Virginia Prepaid Education Program (VPEP)	Prepaid Tuition
Washington	NA	Prepaid tuition
West Virginia		Prepaid tuition
Wisconsin	EdVest Wisconsin (Wisconsin Education Investment Program)	Prepaid Tuition
Wyoming	APHEC	Prepaid Tuition
District of Columbia		To be determined

Key: NA—Not available

Source: National Association of State Treasurers and the College Savings Plan Network.

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